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National Cable Television Association

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October 30, 1996

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.-Rm.222
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
UNIT OF COMMUNITY

Re: CC Docket No. 96-45

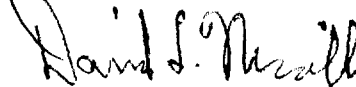
Dear Mr. Caton:

On October 30, 1996, Dan Brenner, Neal Goldberg and David Nicoll of the National Cable Television Association ("NCTA") and Howard Symons of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, met with Dan Gonzalez of Commissioner Chong's office.

The matters discussed are described in the enclosed materials.

If you have any questions concerning this matter, please contact the undersigned.

Sincerely,



David L. Nicoll

DLN:smp

Enclosures

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October 16, 1996

Universal Service: The Cable Industry Perspective

The cable industry, as it begins to offer local telephone service, is committed to participating in the funding of universal service. The existing universal service mechanism: 1) is not competitively neutral, since funds are only available to incumbent carriers and not new entrants; 2) is not explicitly targeted to high cost areas; and 3) encourages inefficient investment. For these reasons, the existing mechanism must be replaced.

In order to encourage facilities-based local telephone competition and ensure that local service rates remain reasonable, a mechanism must be adopted which relies on objective factors, rather than on the reported costs of incumbent local exchange companies. The size of the universal service fund should be restructured in a manner consistent with the goals of the Telecommunications Act of 1996 ("the Act"). An unnecessarily high fund will impose costs on new competitors that will thwart competition in local phone service.

The cable industry recommends the following approach.

Definition

The definition of universal service should include access to voice grade, touch tone, single party residential service, operator services, emergency services, white page listing and a minimum level of local calling.

A definition of universal service must be adopted which gives meaning to all four elements of the test laid out in Sec. 254(c)(1) of the Act, which requires that "universal" services are those that:

- 1) are essential to education, public health, or public safety;
- 2) have, through the operations of market choices by customers, been subscribed to by a substantial majority of residential customers;
- 3) are being deployed in public telecommunications carriers' networks; and
- 4) are consistent with the public interest, convenience and necessity.

Services which have not been subscribed to by a substantial majority of customers, such as vertical services like Caller ID, should not be included in the definition of universal service.

Basis for Contribution

Carriers should be assessed based on their total telecommunications revenues, intrastate and interstate, net of payments to other telecommunications carriers.

In accordance with Sec. 254(d), fairness requires that all telecommunications carriers are assessed using a mechanism that captures the extent of the involvement of a particular industry in providing telecommunications services. Carriers should be assessed based on their total telecommunications revenues, (e.g., local, inter and intrastate access, inter and intraLATA toll, and special access) net of payments (e.g., access charges, payments for unbundled elements, transport and termination, and resale) to other telecommunications carriers. The assessment methodology proposed by USTA and the RBOCs, i.e., assessments based on interstate retail revenues, would not meet the statutory requirement for equitable and nondiscriminatory contributions. This methodology would disproportionately burden new entrants, since RBOCs have virtually zero interstate retail revenue. The vast majority of their interstate revenues are derived from access charges which are defined as wholesale services.

Basis for Receipt

All eligible carriers, including cable companies, must be afforded access to universal service funding on a competitively neutral basis.

All eligible carriers, including cable affiliates, must be afforded access to universal service funding on a competitively neutral basis if they are prepared to serve rural and high cost areas consistent with Sec. 214(e) of the Act. Universal service funding must be made available to all eligible carriers under the terms of the Act. Competitive neutrality requires that funding be made available on a per line basis, and the per line funding amount should be the same for all carriers serving a particular area. This will give carriers an economic incentive to serve an area with the most efficient technology.

Universal Service Mechanism

The Benchmark Cost Model proxy should be adopted, with modifications to the variables which unnecessarily inflate the fund, to objectively identify high cost areas to be supported by the universal service fund.

The Act at Sec. 254(b)(3) calls for support for "...those in rural, insular, and high cost areas, ...", rather than high cost companies. The funding mechanism in use today supports high cost companies that claim to face high costs in providing local service. A proxy cost model must be used to determine high cost areas, rather than high cost companies. The use of a proxy model, which does not depend upon the self-reported costs of ILECs, is the best method of determining where high cost areas exist.

However all proxy models are not created equal. Of the three proxy models, i.e., Cost Proxy Model (CPM), the Hatfield Model and Benchmark Cost Model 2 (BCM2), offered in this docket, the BCM2 is currently the best available model. The CPM and the Hatfield models contain various critical flaws which preclude their adoption. The CPM model relies on a significant amount of unreviewable external models and company-proprietary data that is not available on a nationwide basis, and builds in *substantial excess capacity* for outside plant that reflects engineering decisions relating to services other than primary line basic residential telephone service.¹ The Hatfield model fails the threshold test for consideration because it only analyzes census block groups served by RBOCs, the group least likely to receive funding from an efficient, forward looking proxy model.

BCM2, which uses objective measures of the cost of providing basic local exchange service, is currently the best available model. However, BCM2 requires correction in some particulars: the costs for switching equipment do not reflect the deep discounts (estimated to be 50 percent) routinely extended to LECs by manufacturers; the loading factors, for depreciation and non-plant related expenses, are inflated to reflect embedded costs rather than forward looking incremental costs for overhead loading factors; and the fiber/copper crossover points presume a broadband infrastructure necessary to provide advanced services rather than residential voice grade universal service. All of these variables combine to substantially overstate the size of the required subsidy. We encourage policymakers to modify BCM2's critical variables to be consistent with public policy goals of supporting affordable voice grade residential service. The corrections that ETI identified in *Converging on a Cost Proxy Model for Primary Line Basic Residential Service*, must be adopted before the BCM2 is used as a policy making and universal service tool.

Size of the Fund

The federal universal service fund should be capped at the existing level (approximately \$1 billion) of explicit support mechanisms available today.

The new universal service fund should not exceed the approximate one billion dollar level of existing explicit support mechanisms. It is inappropriate to view the new universal service fund as a vehicle to recover competitive losses or undepreciated plant as local exchange carriers face competition. "Legacy costs" or past investments should not be funded by universal service. To the extent that some costs are unrecoverable due to the entry of competition, the Act contemplates that in exchange for allowing competition in the local exchange market ILECs may enter new lines of business -- the interLATA market in the case of RBOCs, and the video market for all local exchange carriers.

¹ For further discussion see "*Converging on a Cost Proxy Model for Primary Line Basic Residential Service*", Susan M. Baldwin, Lee L. Selwyn, and Helen E. Golding, Economics and Technology, Inc.

Schools and Libraries

Adopt a separate universal service fund for schools and libraries which, at a minimum, guarantees discounts on voice grade service and allows the discount to be applied to advanced services acquired through a competitive bid process, in which all providers may participate.

A separate universal service fund should be established specifically to support schools and libraries. At a minimum, schools and libraries should receive a substantial discount off the current rates for local voice-grade telecommunications services, consistent with Sec. 254(h)(1)(B) of the Act. The discount could be used to augment existing voice grade access or applied to access to advanced services acquired by the school or library through a competitive bid process. To be eligible to apply the schools and libraries universal service funding discount to advanced services access, the school or library must develop a comprehensive, funded education program which includes: a technology needs assessment, and the necessary equipment, teacher training, software and education curriculum development. The funds for the comprehensive education program should be derived from public and private sources, rather than state or local telecommunication taxes or state mandated universal service contributions.²

Administration

The Universal Service Fund should be administered by an independent entity, in a competitively neutral manner, free of the control or influence of the incumbent LECs.

An independent entity should manage the collection and disbursement of subsidies. The independent administrator should be responsible for collection of carrier contributions; disbursement of funds; review and adjustment of the funding requirement; and resolution of disputes regarding the fund. The independent entity could be a pre-existing regulatory body or an entirely independent third party designated by regulators and preferably chosen through a competitively-bid request-for-proposal process. It is essential that the administrator perform its duties in a competitively neutral manner, free of control or influence of the incumbent local exchange carriers so that universal service obligations are not imposed in a manner that frustrates the development of competition.

² For details see "Universal Service for Education: The Cable Industry Perspective."



Universal Service for Education: The Cable Industry Perspective

The cable industry has a number of major initiatives which support education. Through Cable in the Classroom, the industry has contributed more than \$400 million in free school wiring, commercial-free cable programming, equipment and teacher training.

Based on cable's experience and its continuing interest in improving educational opportunities for our nation's children, and the need to accelerate the availability of affordable telecommunications services to schools and libraries, the cable industry urges the Federal-State Joint Board on Universal Service to adopt the framework set forth below.

- I. A separate and distinct universal service fund should be established to support schools and libraries in accordance with the Telecommunications Act of 1996, section 254(h).***

The establishment of a separate schools and libraries universal service fund will ensure that the purpose and focus of this support mechanism is not confused with other mechanisms designed to support telephone service in rural and high cost areas.

- II. The schools and libraries universal service fund should support voice, data and advanced services.***

- At a minimum, the fund should guarantee funding to equip all schools and libraries with voice grade service.

Schools and libraries would receive a substantial discount off an established base rate for lines purchased to augment the schools' and libraries' existing local voice connections. The discount should be significant and provided on a sliding scale (e.g., the first 20 lines at a deeper discount off of the tariffed rate than the next 10 lines). The subsidy would be the difference between the base rate and the discounted rate. Total funding for these purposes would possibly exceed \$1 billion annually, amounting to an average of \$10,000 per institution per year. This is a rough estimate which would support discounted voice grade access for each school and have the flexibility to address the needs of high cost and low income schools and libraries.

- Access to advanced services

If a school chooses to utilize advanced services, then the dollar amount of the discount could be used to reduce the cost of the access to advanced services. These advanced services would be acquired through a competitive bid process.

Any program must be carefully structured to preclude gaming by participants. (e.g., an offer by the incumbent LEC of "free" broadband access for a school or library in exchange for the ordering of excessive numbers of voice grade lines.)

III. *To be eligible to apply the schools and libraries universal service funding discount to advanced services access, the school or library must develop a comprehensive, funded education program which includes: a technology needs assessment, and the necessary equipment, teacher training, software and education curriculum development. The funds for the comprehensive education program should be derived from public and private sources, rather than state or local telecommunication taxes or state mandated universal service contributions.*

IV. *Access to advanced services (such as high speed Internet connections) would be made available to schools and libraries through a competitive bid process.*

- **Competitive Bid Process:**

Requests for proposals would be issued by the local schools and libraries, and states would coordinate the program in accordance with broad federal guidelines. The competitive bid process would ensure that the requested services are made available at the lowest possible price.

- **Eligible Provider:**

In many instances, a nontelecommunications provider may be able to offer access to broadband services which are higher bandwidth, more efficient and effective, and at a lower cost than access offered by a telecommunications provider. To ensure that schools and libraries get the best technology available, it is imperative that all providers be able to participate in the competitive bid process regardless of whether they have contributed to the fund.

- **Funding:**

Consistent with the 1996 Act, carriers should be assessed based on their total telecommunications revenues, net of payments to other telecommunications carriers. All telecommunications providers should be required to contribute to the schools and libraries universal service fund on an equitable and nondiscriminatory basis. Carriers should be assessed based on their total telecommunications revenues (e.g., local, intra and interstate access, intra and interLATA toll, and special access) net of payments to other telecommunications carriers. This would exclude revenues derived from cable services, internet access, and other non telecommunications services.

MEMORANDUM

TO: Federal-State Joint Board on Universal Service

FROM: National Cable Television Association (NCTA)

DATE: October 16, 1996

RE: Eligible Providers of Broadband Access to Schools and Libraries Under Section 254(h)(2)

Attached for your consideration please find NCTA's proposal for bringing telecommunications and access to advanced services to schools and libraries. This proposal is a natural outgrowth of the cable industry's long-standing commitment to bringing new technologies and advanced services to the classroom. It would provide an average of \$10,000 per institution annually toward the purchase of voice, data, and advanced services, and meet the parallel objectives of ensuring universal access to the information age while promoting competition in the provision of these services to schools and libraries.^{1/}

We urge the you to utilize the statutory authority provided under section 254(h)(2) of the Communications Act to enable schools and libraries to choose from among the widest possible array of providers of access to advanced telecommunications and information services, including cable operators and on-line service providers who are not telecommunications carriers. As we explain below, cable modem services and on-line access services are not telecommunications services. Nonetheless, section 254(h)(2) clearly enables the Joint Board to bring these services within the ambit of universal service for schools and libraries, without having to classify them as "telecommunications."

We also note that section 254(b)(4) requires only "providers of telecommunications services" to contribute to universal service. Thus, revenues from cable modem and on-line services could not be used to determine an entity's contribution to the universal service fund. We do not believe that this should be a deterrent to including providers of these services as eligible recipients for funding to provide access to advanced services for schools and libraries, to ensure that educational institutions may choose from among the full range of available broadband options.

^{1/} The funding of universal service for schools and libraries would be separate from and in addition to the mechanism for ensuring that low income and high cost areas have access to basic telecommunications services at affordable rates.

Broad Eligibility Under Section 254(h)(2)

Section 254(h)(2) directs the Federal Communications Commission to establish "competitively neutral rules to enhance . . . access to telecommunications and information services" for schools, libraries, and health care providers. 47 U.S.C. § 254(h)(2). Consistent with the mandate for competitive neutrality, eligibility for universal service support made available pursuant to section 254(h)(2) is not limited to telecommunications carriers. In this significant regard it differs from section 254(h)(1)(B), which specifies that telecommunications carriers are entitled to offsets or reimbursements in connection with the discounted telecommunications services they provide.^{2/}

With the adoption of section 254(h)(2), Congress recognized that the most efficient provider of access to advanced services may not be a telecommunications carrier. In many circumstances, cable operators, on-line service providers, and other entities that are not common carriers may be able to offer access with greater bandwidth capacity at a lower cost than access offered by telecommunications providers. Section 254(h)(2)'s mandate of competitive neutrality ensures that any entity can compete to provide access to schools and libraries regardless of whether it is a telecommunications carrier.

Regulatory Classification of Access to Advanced Services

Internet access and on-line services are not telecommunications services. "Information services" and "enhanced services" provided over the facilities of common carriers have long been treated as separate and distinct from the basic telecommunications capacity used to transmit those services.^{3/} Under the 1996 Act, moreover, neither the

^{2/} 47 U.S.C. § 254(h)(1)(B). The broad language of section 254(h)(2) would permit the funding of access to advanced services by applying the discount established for telecommunications services.

^{3/} Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 77 FCC 2d 384 (1980) ("Computer II Final Order") (subsequent history omitted). A common carrier's basic transmission capacity is a telecommunications services that must be made available to any information service providers under tariff. Independent Data Communications Mfrs. Assoc., DA 95-2190 (rel. Oct. 18, 1995) ("Frame Relay Order"), at ¶¶ 13, 59, citing Computer II Final Order, 77 FCC 2d at 475. A common carrier's Internet access service is not a telecommunications service, however. See, e.g., Bell Atlantic Offer of Comparably Efficient Interconnection to Providers of Internet Access Services, CCBPol 96-09, DA 96-981 (rel. June 6, 1996), at ¶ 2.

Internet access services offered by cable operators nor the underlying cable network used to distribute them are subject to regulation as telecommunications offerings.^{4/}

As noted above, there is no justification or need to reclassify these services as telecommunications services in order to bring them within the scope of universal services for schools and libraries.^{5/} While section 254(h)(1)(B) appears to limit certain universal service support to telecommunications services provided by telecommunications carriers, section 254(h)(2) contains no such restrictions. To the contrary, section 254(h)(2) contemplates the inclusion of "access" as part of universal service without regard to the regulatory treatment of access services.

Because access services are not telecommunications services, moreover, revenues from those services cannot be used to determine an entity's universal service contribution. Under section 254(b)(4), only "providers of telecommunications services" must contribute to universal service.^{6/} To the extent a cable operator or any other provider of Internet access services is also providing telecommunications services, it would of course be obligated to contribute to universal service. To require a contribution from Internet access or on-line revenues, however, the Joint Board must either expand the scope of contributions beyond providers of telecommunications services or effectively reclassify these services as telecommunications services in order to bring them within the contribution requirement. Neither course is supported by the 1996 Act or the past treatment of Internet access and on-

^{4/} Section 301(a)(1) of the 1996 Act adds "or use" to the definition of cable service. As amended, that definition now includes "the one-way transmission of . . . other programming service, and subscriber interaction . . . which is required for the selection or use of such . . . other programming service." "Other programming service" means "information that a cable operator makes available to all subscribers generally." 47 U.S.C. § 522(14). The amended definition of cable service is intended "to reflect the evolution of cable to include interactive services such as game channels and information services made available to subscribers by the cable operator, as well as enhanced services." H.R. Conf. Rep. 104-458, at 169 (1996) ("Conference Report"). A cable system is not subject to common carrier requirements. 47 U.S.C. § 541(c) ("A cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service.").

^{5/} Such an expansion of regulation would be inconsistent with the historic treatment of these services, and fundamentally at odds with the "pro-competitive, de-regulatory national policy" embodied in the Telecommunications Act of 1996. Conference Report at 1.

^{6/} 47 U.S.C. § 254(b)(4).

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line services.¹⁷ To do so now would represent an abrupt departure from the historically unregulated nature of these services.

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¹⁷ Indeed, providers of information services are exempt from paying the network access charges applicable to interexchange carriers. Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, 3 FCC Rcd 2631 (1988).